# SICPA

#### MASSACHUSETTS

#### Illegal Tobacco Commission

Alex Finkel Vice President, Operations SICPA November 19, 2013



**Enabling trust** 



#### **AGENDA**

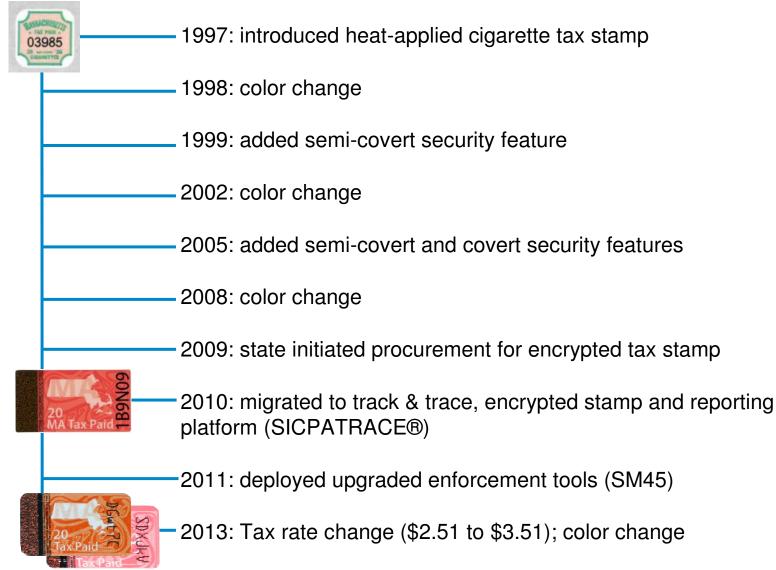
- History of the Massachusetts Tax Stamping Program
- II. Current Environment
- III. Best Practices
  - A. Regulations
  - B. Oversight & Penalties
  - C. Enhanced Enforcement Tool // SICPATRACE®
    - Overview
    - Benefits
- IV. Additional Services for Consideration
- V. Market Trends
- VI. Best Practices Summary





## I. HISTORY OF THE MASSACHUSETTS TAX STAMPING PROGRAM

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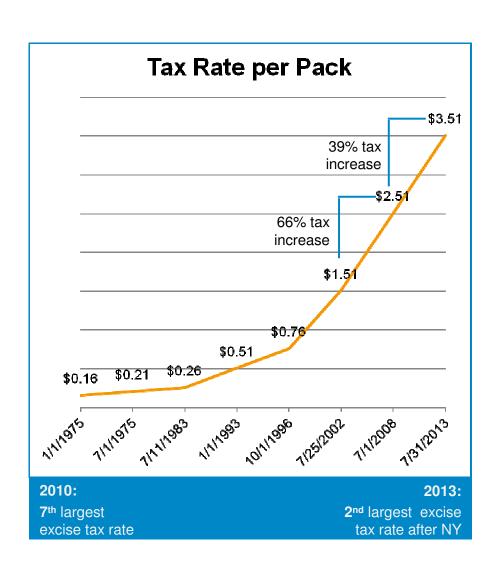


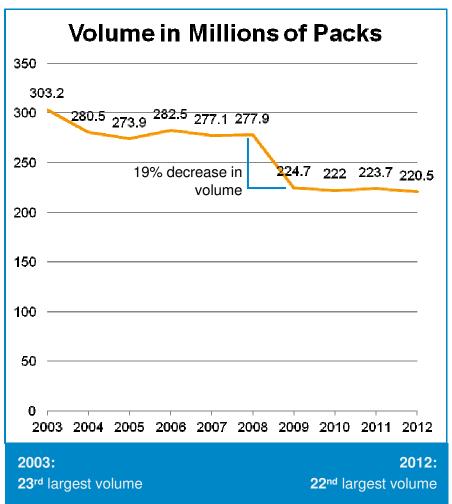


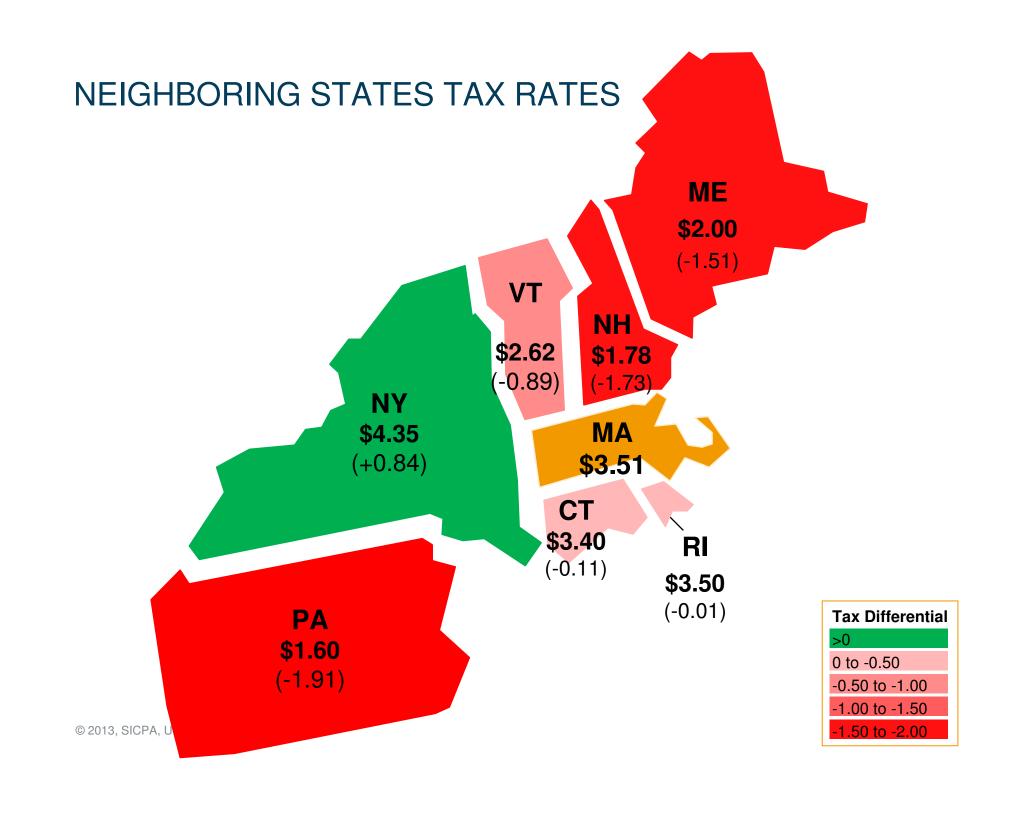


II. CURRENT ENVIRONMENT

## MASSACHUSETTS CIGARETTE TAX RATES AND VOLUMES OVER THE YEARS







#### ILLICIT ACTIVITY // INCENTIVES

- All cigarette trafficking schemes, regardless of method, depend upon tax avoidance
- Increase in cigarette tax rates → increase in incentives for tax avoidance
  - Higher profit margins for the sale of an illicit pack of cigarettes
    - Now higher than for cocaine, heroin, marijuana or arms trafficking
  - Consumer willingness to buy at lower (less prohibitive) price increases
  - Limited fines and criminal charges
  - No significant changes to enforcement personnel or efforts

#### ILLICIT ACTIVITY // EXAMPLES

- Unstamped cigarette sale (Duty Free, Counterfeit, NC/SC/ND)
- Cigarettes stamped with another jurisdiction's stamp
  - Interstate smuggling (Smurfing or Large Scale) from low or no tax rate to higher tax rate, wholesale, retail, reservations
- Counterfeit cigarette tax stamps
- Non-reported / under reported cigarette sales (Sales and Corporate Tax)
- Under- or Non-declared Manufacturer, Native and Tribal production

#### ILLICIT ACTIVITY // TRACE SCHEMES

#### Illicit Trade Schemes Profit by Evading Taxes and Fees

		TAXES AND	FEES AVOIDE	FEES AVOIDED	
RELATIONSHIP TO SUPPLY CHAIN	EXAMPLES OF ILLICIT TRADE SCHEMES	Customs duty	Federal excise tax	State/local excise tax	MSA/escrow payment
IMPORT	Smuggling genuine or counterfeit cigarettes into the United States     Purchasing cigarettes from foreign Internet Web sites without appropriate payment of tax	×	×	×	×
EXPORT	Diverting export-only cigarettes into U.S. commerce	NA	×	×	×
MANUFACTURE	Manufacturing cigarettes in the United States without a license	NA	x	×	×
WHOLESALE/DISTRIBUTION	Underreporting cigarette production to federal government	NA	Paid	×	×
RETAIL	Purchasing tobacco products from retailer in one state for illegal transportation and resale in another state     Purchasing cigarettes in Indian country for resale to nontribal members     Purchasing cigarettes from domestic Internet Web sites without appropriate payment of tax	NA	Paid	×	×
OTHER	Underreporting cigarette sales to MSA states	NA	Paid	Paid	×

Source: GAO analysis

Note: In some wholesale/distribution and retail schemes, state excise taxes are paid in the state where the tobacco products are purchased, but unpaid in the state where the tobacco products are illicitly resold.

#### ILLICIT ACTIVITY // MASSACHUSETTS CONCERNS

- @\$3.51 / pack, MA has the 2<sup>nd</sup> highest cigarette tax rate in the U.S behind New York State.
  - 60% of cigarettes consumed in NY (highest cig tax rate) are smuggled (estimation from Tax Foundation, 2011)
- The July 31<sup>st</sup> tax increase shown some impacted excise tax collection:
  - 15% drop in cigarette tax stamp sales in MA in August and October '13 when compared with 2012 not a trend but should be monitored
  - Bordering cities have reported an increase in cigarette sale volumes
- In addition to lower excise tax revenue collection, there are other areas impacted by tax avoidance
  - Impacts MSA payments
  - Sales tax payments
  - Incentive for illicit actors to divert product from nearby states





III. BEST PRACTICES

## BEST PRACTICES OVERVIEW

Tax avoidance is unavoidable

Able to limit the degree of tax avoidance

Requires a comprehensive, multi-faceted approach







III.A. BEST PRACTICES // REGULATIONS

#### BEST PRACTICES // REGULATIONS

#### Control of and visibility into supply chain – SICPATRACE®

- Data capture at the time of stamp application done by the Commonwealth
- All data collected is owned by the Commonwealth
- Maintenance of authorized Tobacco Product Directory
- Automated capture and electronic filing of required forms and reports (expansion)

#### Licensing Requirements

- Enabling legitimate distributor and retailer market
- Robust permitting and licensing requirements with minimum renewal periods
- License revocation for any type excise tax avoidance (Zero Tolerance)
- Background check for license applicants

#### BEST PRACTICES // REGULATIONS

#### Incentivize Prosecution

Increase criminal code classifications for first and repeat offenses

#### Enhanced Coordination

 Coordination with other agencies and local law enforcement within the Commonwealth and I-95 corridor jurisdictions (e.g., NW3C, NESPIN, RISS, ROCIC)

#### Product and Revenue

- Consumer perception of replacement products due to tax changes (e.g., RYO and Pipe)
- New products that do not have physical presence of tobacco leaf
- Data capture through continued enhancement of electronic reporting and filing (FTA Uniformity, TX HB11)





## III.B. BEST PRACTICES // OVERSIGHT & PENALTIES

#### BEST PRACTICES // OVERSIGHT & PENALTIES

The number of overall seizures for the past three years has dropped significantly because of the enforcement presence and encrypted stamps.

-Joe McDermott, Deputy Commissioner of Audit, November 7, 2013

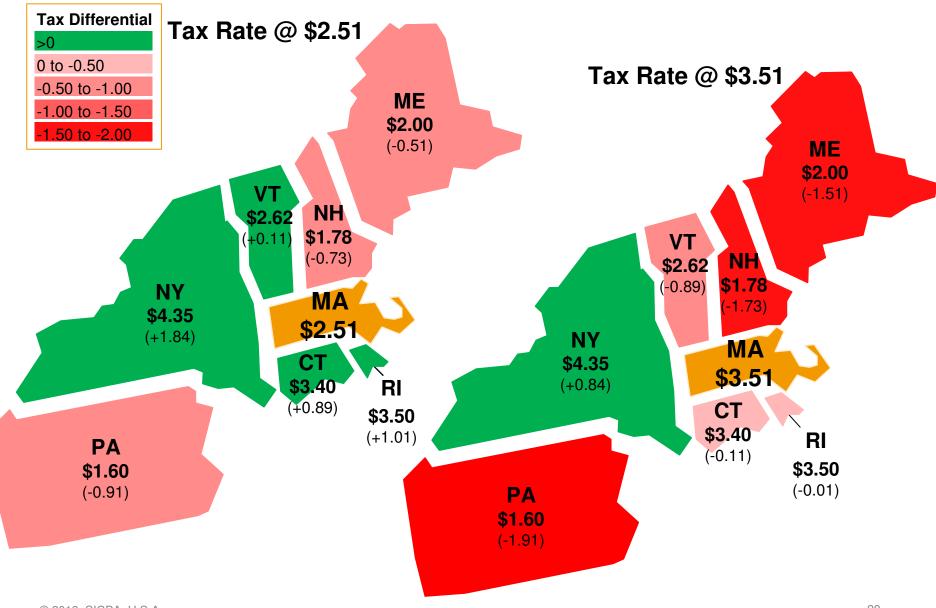
#### Enforcement oversight - SICPATRACE®

- Ability to validate stamp audit results in real-time
- Locational visibility for audit activity
- Cross-tax reconciliation and auditing (e.g., Excise vs. Sales)

#### Increase # of enforcement personnel

- Dedicated tobacco unit
- Train law/criminal enforcement on seriousness of illegal cigarette trafficking
- Increase Penalties (i.e. VA Crime Commission)
- Possession of stamped product with intent to distribute
- Possession of unstamped product
- Forfeiture of property used in connection with cigarette trafficking

#### BEST PRACTICES // AUDIT PATTERNS







II.C. BEST PRACTICES // ENHANCED ENFORCEMENT TOOL // SICPATRACE®

#### SICPATRACE® OVERVIEW // COMPONENTS

ENCRYPTED COUNTERFEIT RESISTANT STAMP AUDITING TOOLS

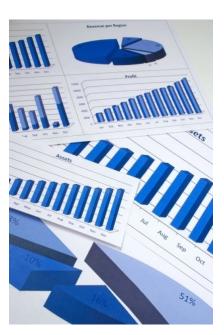
DATA
MANAGEMENT
SYSTEM

REPORTING CAPABILITIES





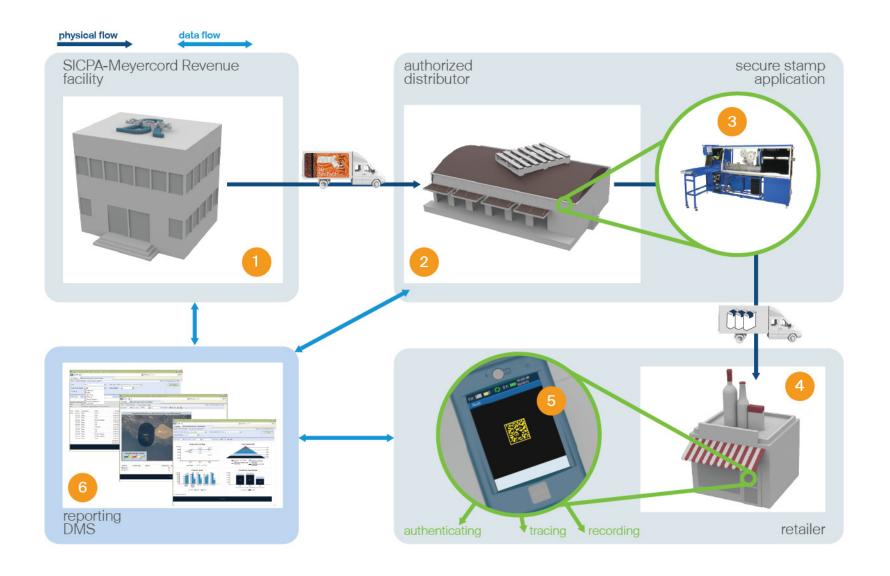




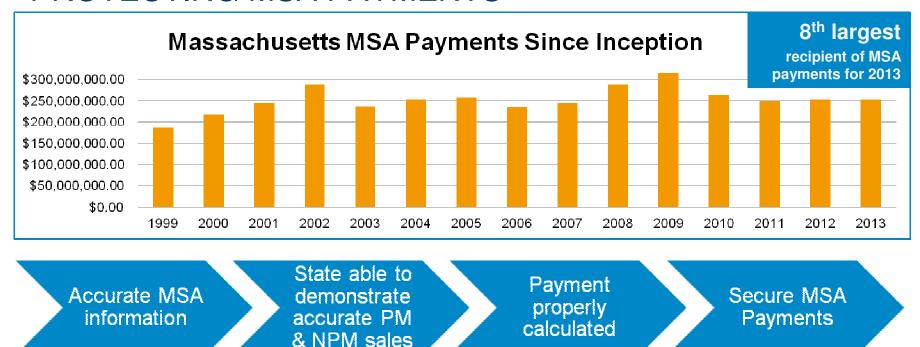
#### SICPATRACE® BENEFITS

COMBATING ILLICIT TRADE	unparalleled level of physical- and information-based security
PROTECTING MSA PAYMENTS	more accurate reporting of cigarette sales by type and manufacturer
MAKING EFFECTIVE DECISIONS	more efficient and targeted reporting generated from enhanced field audit tools
PROTECTING PUBLIC HEALTH	reduces the proliferation of counterfeit products enables more revenues to be used for tobacco cessation programs
SECURING THE SUPPLY CHAIN	visibility into and control over tobacco distribution channels

#### SICPATRACE® OVERVIEW // PROCESS



## BEST PRACTICES // SICPATRACE® BENEFITS PROTECTING MSA PAYMENTS



Example of failure to diligently enforce:

Pennsylvania, the 5<sup>th</sup> largest recipient of MSA payments in 2013, stands to lose **\$180 MILLION** (60% of the state's 2014 MSA payment) due to recent arbitration ruling related to non-participating manufacturers (NPM) and reduced market share for participating manufacturers (PM).

http://gantdaily.com/2013/10/03/administration-notified-about-tobacco-master-settlement-agreement-arbitration-panel-decision/

## BEST PRACTICES // SICPATRACE® BENEFITS KEY STAKEHOLDER SUPPORT

- 24x7 Operations and Customer Service organization, monitoring in real-time, all field deployed modules (Stamp Manufacturing, Distributor Stamping, Field Enforcement and Data Generation)
- Proactive monitoring system to help identify and solve issues
  - Reacts quickly, sometimes even before the user knows there is an issue
- Minimizes downtime for distributors and ensures integrity in supply
- Supports Field Enforcement reviews and drives with data

#### BEST PRACTICE // **COMMUNITY OUTREACH PROGRAM**

- Joint preparation of educational materials for retail locations and consumer outreach
  - Stamp information sheet for distributors
  - validation device fact sheet for retailers
- Cost effective stamp validation tool (VA-11) to retail outlets and distribution partners available for purchase



Cigarette Tax Stamp

Simple to authenticate Difficult to reproduce

A new cigarette tax stamp program is now being implemented throughout the Commonwealth. The program includes the use of two different stamp

> A red stamp is affixed to packs of 20 cigarettes.
> This stamp reads: "20 Tax Paid."





A vellow stamp is affixed to packs of 25 cigarettes





\*Not actual size. For representation purposes only.

The new cigarette tax stamps are highly secure, utilizing a visible red-to-green color shift on the left side of the stamp



#### Massachusetts DOR New Excise Stamp Information Sheet: Retailers

The new Cigarette Excise Stamp Program now in place throughout the Commonwealth of Massachusetts

A red stamp is affixed to packs of 20 cloarettes. Note this stamp reads: "20 Tax Paid:









Stamps will look the same except for the denomination and color (red or yellow)

Retailers and consumers should look for the following features on all Massachusetts stamps beginning May 2010 and planned to be fully implemented by August 2010:

- A golor-shifting effect visible to the human eye on the left edge of all stamps: tilting the stamp slightly shows a red-to-green effect. Hold the stamp in front of you and note the color pack and see the color of the left side image change on the stamp. If the ink doesn't appear shiny and change color, it's not a genuine stamp.

  A unique 8-digit alpha-numerio code on the right side of the stamp allows for effective
- enforcement and tracking. No two stamps will have the same number. If you see two stamps with the same number you know at least one is counterfeit.
- Tamper-evident surface outs, which make it difficult to remove or tamper with the tax stamps
- An Image of the Commonwealth of Massachusetts with the abbreviation "MA" inside the state graphic. This Massachusetts-specific information helps to make stamp jurisdiction easily identifiable—no other state's stamp looks like ours.

Under G.L. c. 64C, sec. 33, retailers may not accept deliveries of unstamped or improperly stamped packs of cigarettes. Every licensed retailer must immediately examine all packages of cigarettes it receives and immediately return to its supplier any packs of cigarettes that are unstamped or improperly stamped. A stamp other than that carrying the Massachusetts design is considered unstamped.

#### Frequently Asked Questions:

What happens if a stamp doesn't look the same as the others? First, look closely at the color-shifting print effect. If the link does not shift color on the left side of the stamp, put the cigarette pack aside and notify the DOR.

In addition to its easily verifiable overt features, the color shift effect on the new stamp provides a covert polarizing effect. To further authenticate the stamp, a special

double filter validation device is available to retail tobacco licensees. This validator uses filters consisting of two types of polarizing material that reveal different color shades from the same ink. Through the right-hand filter, the ink appears bright, while through the other filter it appears dark. If you do not see this effect when using the validator, the stamp may not be genuine

SICPA SICPA OASIS" VALIDATOR

Validators are specifically designed to match the color-shift feature on genuine cigarette tax stamps. This device provides retail

- Practical
- Hand-held
- · Easy to use Effective
- · Small and light as a credit card
- Reasonably-priced

Genuine stamps are simple to authenticate, bu should put yet very difficult to reproduce. Validators enable retail tobacco licensees to

cigarette tax stamp. e beginning of xisting stamped

Validator Purchasing Information Validators can be purchased only by

authorized DOR vendor. The website links

Each validator is \$20.00, plus sales tax

and shipping and handling. Valid credit card payment is required at time of purchase. All retail tobacco licensees will be prompted to provide their license number, which will be verified by DOR.

to an order form for purchases.

be shipped direct to licensees.

retail tobacco licensees through an online ordering system, accessible through the DOR website: www.mass.gov/dor

/alidators will be distributed by ar

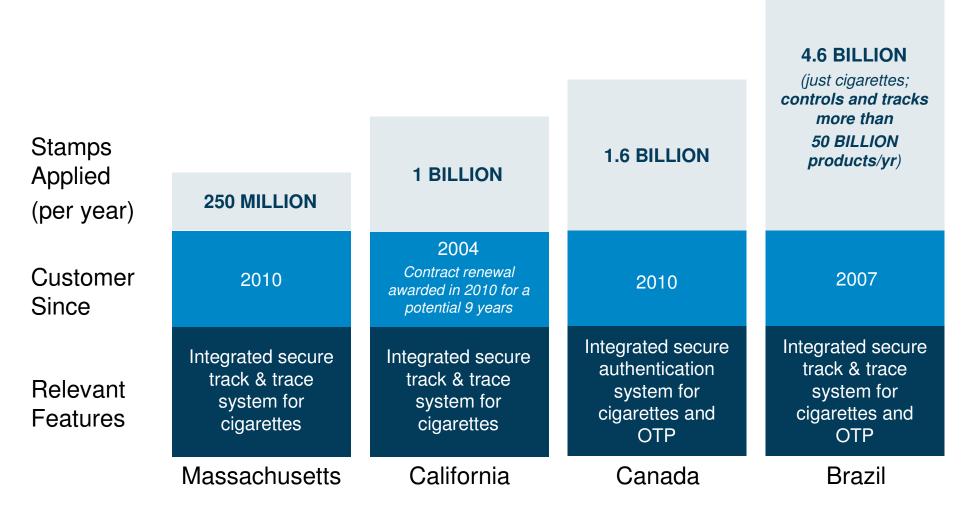
n recycled paper.

#### Once the order is approved, validators will Additional Stamp Information

If you notice any cigarette packs at your are improperly stamped or if a stamp does not appear to be genuine, notify the DOR Cigarette and Tobacco Excise Unit by email at maexcisestamp@dor.state.ma.us or by telephone at 617-887-5090.

Please also visit www.mass.gov/dor for further information and details on the

## BEST PRACTICES // LEVERAGING OTHER DEPLOYMENTS







ADDITIONAL TOOLS FOR CONSIDERATION





#### III. MARKET TRENDS: LOOKING BEYOND CIGARETTES

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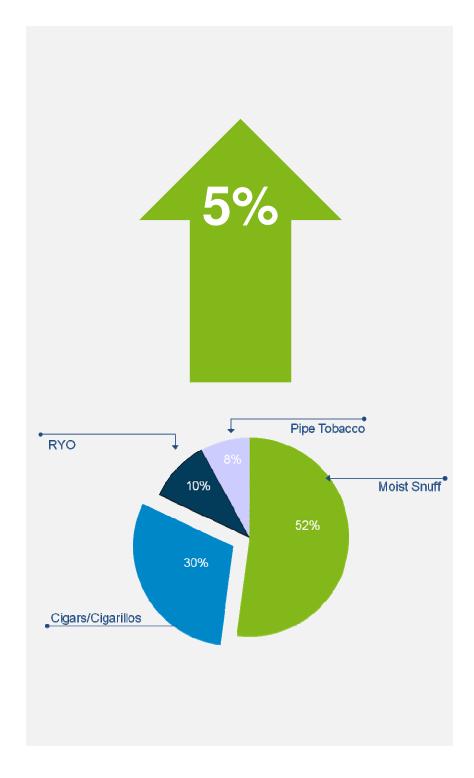
- According to American Wholesale Marketers Association (AWMA):
  - Cigarette volumes are down 2% year over year
  - Other Tobacco Products (OTP) and E-cigarettes are continuously growing YOY
    - ► E-Cigarette unit sales are growing by 234%
  - Retailers are allocating more space to key subcategories (OTP and Ecigarettes)
- OTP and E-Cigarettes are impacting cigarette sales
- States MUST establish regulations, including tax collection/control mechanisms and penalties, in order curb illicit trade in these up and coming markets

## OTP – CONTINUED AND STEADY GROWTH

- OTP's annual revenue growth year over year is 5%
- OTP comes in many different shapes, sizes, flavors and prices
- OTP is often marketed as safer, cheaper, able to use in non-smoking environments, or more discreet than cigarettes

The average convenience store sold \$55,960 in OTP products in 2010, an 11% increase over 2009.

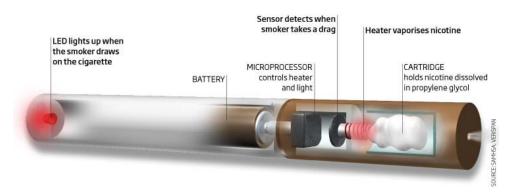
- Convenience Store News



#### **E-CIGARETTES**

#### Smoke without fire

Suck on an e-cigarette and it produces a cloud of nicotine-carrying vapour with none of the toxic by-products of burning tobacco



- 2.5 MILLION e-cigarette smokers (45 million total smokers in the U.S.)
- \$1.50 cost of e-cigarette equivalent to a pack of cigarettes (\$8.77 in MA)
- \$1.7 BILLION e-cigarette sales predicted in 2013 (\$500 million in sales in 2012; over 50% growth)
  - STATE to currently levy an excise tax on e-cigarettes (Minnesota taxes e-cigarettes as OTP)





II.D. BEST PRACTICES SUMMARY

#### BEST PRACTICES SUMMARY

Enhance Enforcement Efforts	<b>✓</b>
Upgraded enforcement tools – best-of-breed mobile reader SICPAMOBILE® SM45	<b>✓</b>
Dedicated tobacco unit	
Increase number of enforcement personnel	
Expand Regulations and Policy	
Increase penalties for offenders and deploy a stricter enforcement code (limit # of stamped cigarettes, increased penalties for unstamped cigs, lower quantity threshold and increase penalties for subsequent violations, property forfeiture used in connection with illicit activity)	
Support Key Stakeholders	<b>✓</b>
Proactive infrastructure monitoring and effective support	✓
Protect MSA Payments	<b>✓</b>
More accurate and better reporting of MSA information	✓
Continuous Improvement	<b>✓</b>
Improving stamp security – SICPATRACE® multi-layered counterfeit resistant stamp	<b>✓</b>
Implementing lessons learned from similar deployments	WIP
Improving reporting platform – SICPATRACE® reports	•
Expand Excise Tax Program	
Expand program to products such as OTP and e-Cigarettes	
SICPATRACE® can support a multi-product platform	•
Expand program to include invoice capture/e-reporting	

### QUESTIONS?



## THANK YOU FOR YOUR ATTENTION



# SICPA